

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name: <u>City of Pontiac General Employees' Retirement System</u>	County Oakland
Audit Date December 31, 2003	Opinion Date April 30, 2004	Date Accountant Report Submitted To State: June 14, 2004	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:


1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on individual federal assistance programs (program audits).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Single Audit Reports (ASLGU).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Certified Public Accountant (Firm Name): PLANTE & MORAN, LLP			
Street Address 27400 Northwestern Highway	City Southfield	State MI	ZIP 48034
Accountant Signature 			

City of Pontiac
General Employees' Retirement System

Financial Report
with Required Supplemental Information
December 31, 2003

City of Pontiac General Employees' Retirement System

Contents

Report Letter	I
Management's Discussion and Analysis	2-3
Basic Financial Statements	
Statement of Plan Net Assets	4
Statement of Changes in Plan Net Assets	5
Notes to Financial Statements	6-9
Required Supplemental Information	
Schedule of Analysis of Funding Progress	10
Schedule of Employer Contributions	11



Plante & Moran, PLLC
27400 Northwestern Highway
P.O. Box 307
Southfield, MI 48037-0307
Tel: 248.352.2500
Fax: 248.352.0018
plantemoran.com

Independent Auditor's Report

To the Retirement Board
City of Pontiac General Employees'
Retirement System

We have audited the accompanying statement of plan net assets of the City of Pontiac General Employees' Retirement System (a component unit of the City of Pontiac, Michigan) as of December 31, 2003 and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the General Employees' Retirement Board of the City of Pontiac. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac General Employees' Retirement System as of December 31, 2003 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

April 30, 2004



A worldwide association of independent accounting firms

City of Pontiac

General Employees' Retirement System

Management's Discussion and Analysis

Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

General Employees' Retirement System

	Fiscal Year Ended December 31	
	2003	2002
Total assets	\$ 452,762,655	\$ 401,080,951
Total liabilities	42,385,046	42,888,692
Assets held in trust for pension benefits	\$ 410,377,609	\$ 358,192,259
Net investment gain (loss)	\$ 65,769,097	\$ (27,355,217)
Net securities lending income	55,264	65,897
Contributions:		
Employee - Reinstated members	25,847	27,217
Employer	10,608	77,889
Retiree pension and annuity benefits	13,167,229	12,347,405
Benefits paid in excess of contributions	13,130,774	12,242,299
Ratio of benefits paid to contributions	361.2%	117.5%
General and administrative expenses	508,237	425,424
Net increase (decrease) in net assets held in trust	\$ 52,185,350	\$ (39,957,043)

City of Pontiac

General Employees' Retirement System

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The General Employees' Retirement System (the "System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The public capital markets represent the primary source of investments.

Asset Allocation

The General Employees' Retirement System has established asset allocation policies, which are expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following are the adopted asset allocation targets as of December 31, 2003:

Domestic equities	40%
International equities	10%
Domestic fixed income	36%
Global fixed income	8%
Real estate	5%
Cash	1%

Investment Results

The investment performance showed a marked improvement from the past three years of a highly challenging period of declining values in the capital markets. The stock market, as measured by the S&P 500 index, returned 28.7 percent as compared to the prior year at a negative 22 percent. The System experienced a healthy gain on its investment portfolios owing primarily to the improvement in the market value of stocks. Returns from fixed income investments declined to historic lows in the summer of 2003 due in large part to Federal Reserve monetary policy and remained slightly positive. The total fund returned 19.5 percent for the year.

While this year's total fund investment return is significantly better than the prior year, it must be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the System to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the Board of Trustees must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years.

City of Pontiac

General Employees' Retirement System

Statement of Plan Net Assets December 31, 2003

Assets

Cash (Note 3)	\$ 100,551
Cash and investments held as collateral for securities lending (Note 3)	41,670,729
Accrued interest and dividends receivable	1,665,225
Accounts receivable:	
Due from broker for pending transactions	487,626
Due from GERS VEBA	16,545
Due from City Payroll Fund	10,608
Other receivable	3,052
Investments at fair value - including loaned securities (Note 3):	
Money market funds	7,034,654
Preferred securities	545,470
Convertible securities	43,223
U.S. government agency notes and debentures	17,327,164
Corporate and other bonds	61,140,445
Equities	256,114,366
U.S. government agency mortgage pools	47,914,595
Real estate	18,688,402
	<hr/>
Total investments	408,808,319
	<hr/>
Total assets	452,762,655

Liabilities

Due to City of Pontiac	290,433
Due to City of Pontiac Police and Fire Retirement System	2,419
Accounts payable	421,465
Amounts due broker under securities lending agreement (Note 3)	41,670,729
	<hr/>
Total liabilities	42,385,046

Net Assets Held in Trust for Pension Benefits (a schedule of funding progress is presented in the required supplemental information) **\$ 410,377,609**

City of Pontiac

General Employees' Retirement System

Statement of Changes in Plan Net Assets Year Ended December 31, 2003

Additions

Investment income:	
Interest and dividend income	\$ 10,576,786
Net appreciation in fair value	56,784,221
Investment advisor fees	<u>(1,591,910)</u>
Net investment income	65,769,097
Securities lending income:	
Interest and fees	455,914
Less borrower rebates and bank fees	<u>(400,650)</u>
Net securities lending income	55,264
Contributions:	
Employer	10,608
Employee - Reinstated members	<u>25,847</u>
Total additions	65,860,816

Deductions

Retirees' pension benefits and retirement incentives	13,167,229
Other expenses	202,625
Charges from the City of Pontiac - Administrative expenses	<u>305,612</u>
Total deductions	<u>13,675,466</u>

Net Increase in Net Assets Held in Trust for Pension Benefits 52,185,350

Net Assets Held in Trust for Pension Benefits - January 1, 2003 358,192,259

Net Assets Held in Trust for Pension Benefits - December 31, 2003 \$ 410,377,609

City of Pontiac

General Employees' Retirement System

Notes to Financial Statements
December 31, 2003

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the General Employees' Retirement System (the "System") (a contributory single-employer retirement plan) that covers substantially all employees of the City, except police and fire employees.

Reporting Entity - The financial statements of the System are also included in the combined financial statements of the City of Pontiac as a pension trust fund. The assets of the pension trust fund include no securities of or loans to the City of Pontiac or any other related party. At December 31, 2003, there were no investments in any one organization in excess of 5 percent of net assets available for benefits.

Basis of Accounting - The City of Pontiac General Employees' Retirement System's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Methods Used to Value Investments - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals.

Note 2 - Plan Description and Contribution Information

At December 31, 2002, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving pension benefits and terminated employees entitled to benefits but not yet receiving them	<u>1,300</u>
Current employees:	
Fully vested	213
Nonvested	<u>260</u>
Total current employees	<u>473</u>

City of Pontiac

General Employees' Retirement System

Notes to Financial Statements
December 31, 2003

Note 2 - Plan Description and Contribution Information (Continued)

Plan Description - The System provides retirement benefits, as well as death and disability benefits. Employees may receive cost-of-living adjustments as a percentage of their base amount, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by City ordinance and negotiation with the employees' collective bargaining units.

Contributions - Plan members are not required to contribute. The City is required to contribute at an actuarially determined rate. Administrative costs are financed through investment earnings.

Note 3 - Deposits and Investments

Deposits - At year end, total bank deposits were comprised of \$100,551 without recognition of deposits in transit or outstanding checks, of which \$100,000 was covered by federal depository insurance.

Investments - The System is authorized by Michigan Public Acts to invest in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, bankers' acceptances and mutual funds, investment pools that are composed of authorized investment vehicles, certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

All of the System's investment securities, other than \$40,424,506 of securities lent to broker-dealers, are either insured, registered, or are held by the System or its agents in the System's name. Securities lent to broker-dealers are not categorized by investment risk. Management believes that the investments of the System comply with the investment authority noted above.

Included in the System's investments at December 31, 2003 are the following:

- Approximately \$10,975,000 of securities issued by the Government National Mortgage Association (GNMA). These investments are backed by the full faith and credit of the U.S. government. The yields provided by these mortgage-related securities historically have exceeded the yields on other types of U.S. government securities with comparable maturities, in large measure due to the potential for prepayment. Prepayment could result in difficulty in reinvesting the prepaid amounts in investments with comparable yields.

City of Pontiac

General Employees' Retirement System

Notes to Financial Statements
December 31, 2003

Note 3 - Deposits and Investments (Continued)

- Approximately \$36,939,000 of obligations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. These investments are usually not backed by the full faith and credit of the U.S. government, but are generally considered to offer modest credit risks. The yields provided by these mortgage-related securities historically have exceeded the yields on other types of U.S. government securities with comparable maturities, in large measure due to the potential for prepayment. Prepayment could result in difficulty in reinvesting the prepaid amounts in investments with comparable yields.
- Approximately \$864,000 of corporate strips. These strips represent purchases of the principal portion of corporate notes. Similar to zero coupon bonds, strips are purchased at a discount (which represents the future interest earnings of the instruments). The discount is amortized over the remaining maturity of the instrument. There is no prepayment risk associated with these instruments as the corporation is not allowed to call them early. Purchases of these strips allow the System to lock in favorable interest rates for the term of the security.

As permitted by State statutes, and under the provisions of a Securities Lending Authorization Agreement, the General Employees' Retirement System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The General Employees' Retirement System's custodial bank manages the securities lending program and receives cash as collateral. Borrowers are required to deliver collateral for each loan equal to not less than 100 percent of the market value of the loaned securities. During the year ended December 31, 2003, only United States currency was received as collateral.

The General Employees' Retirement System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank.

City of Pontiac

General Employees' Retirement System

Notes to Financial Statements
December 31, 2003

Note 3 - Deposits and Investments (Continued)

The General Employees' Retirement System and the borrower maintain the right to terminate all securities-lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in an investment pool. The average duration of such investment pool as of December 31, 2003 was 28 days. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On December 31, 2003, the General Employees' Retirement System had no credit risk exposure to borrowers. The collateral held and the fair market value of underlying securities on loan for the General Employees' Retirement System as of December 31, 2003 were \$41,670,729 and \$40,424,506, respectively.

Note 4 - Reserves

State law requires employee contributions to be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of December 31, 2003, the System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 5,434,839
Reserved for retired employees	128,013,483

Required Supplemental Information

City of Pontiac

General Employees' Retirement System

Required Supplemental Information Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/95*	\$ 237,353,362	\$ 174,206,716	\$ (63,146,646)	136.2	\$ 15,057,551	-
12/31/96*	256,723,386	184,624,697	(72,098,689)	139.1	15,915,806	-
12/31/97**	287,764,412	189,207,579	(98,556,833)	152.1	18,295,631	-
12/31/98	315,420,281	194,984,577	(120,435,704)	161.8	18,362,384	-
12/31/99*	350,846,897	209,172,136	(141,674,761)	167.7	18,747,510	-
12/31/00*	378,063,942	217,942,909	(160,121,033)	173.5	18,728,688	-
12/31/01**	395,743,819	227,901,435	(167,842,384)	173.6	19,887,803	-
12/31/02*	393,214,033	235,422,367	(157,791,666)	167.0	20,039,136	-

* Plan amended

** Certain assumptions revised

City of Pontiac

General Employees' Retirement System

Required Supplemental Information Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
1997	\$ 1,068,980	122.33
1998	598,231	165.40
1999	133,572	218.90
2000	175,021	100.00
2001	139,583	119.00
2002	46,888	166.00
2003	10,608	100.00

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2002, the latest actuarial valuation, is as follows:

Actuarial cost method	Individual entry age normal cost
Amortization method	Level percent of payroll, closed periods
Remaining amortization period	12 - 21 years
Asset valuation method	Market value with five-year smoothing of gains and losses
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	4.5% to 9.4%
*Includes inflation at	4.5%
Cost-of-living adjustments	2% (2.5% Court/MAPE) of original amount, subject to a maximum that varies by group

April 30, 2004

Mr. Eugene White, Chairman (GERS)
Mr. Craig Storum, Chairman (PFRS)
Mr. Ed Hannan, Chairman (General VEBA)
Mr. Todd Courtney, Chairman (Police and Fire VEBA)
City of Pontiac Retirement Boards
General Employees Retirement System
Police and Fire Retirement System
47450 Woodward Avenue
Pontiac, MI 48342

Dear Mr. White, Mr. Storum, Mr. Hannan and Mr. Courtney:

We recently completed the audits of the General Employees Retirement System and the Police and Fire Retirement System (the Systems), as well as the related VEBAs, for the year ended December 31, 2003. We continue to be impressed with the organized and thorough manner in which Deborah Munson prepared for the audit. Her assistance in preparing the necessary schedules was greatly appreciated. As a result of the audit, we offer the following comments and recommendations for your consideration:

GASB Proposed Change

The GASB recently issued an exposure draft related to post-employment benefits, including healthcare. While still in the proposal stage, this pronouncement could have a material impact on the City's required contribution for healthcare. GASB is recommending that the healthcare liability be funded in the same manner as pensions. As such, under this proposal the City would be required to have an actuarial valuation performed of the healthcare liability on a regular basis. The resulting annual required contribution would need to be funded by the City on a current basis. This change would be effective in 2006.

Contributions

The actuary report addresses the timing of contribution payments from the City to the Systems. The actuary report states that contributions are assumed to be made on a regular basis. Any significant deviation from the original contribution requirements may trigger an adjustment to some actuarial assumptions. During the audit, we noted a time lag in the City's remittance of contributions to the General VEBA. In order to avoid any negative impact on the Systems, we recommend that the Retirement System continue working with the City to facilitate the timeliness of contributions to the Systems.

Investments

The System should perform regular analyses of its investments to ensure compliance with the Public Employee Retirement System Investment Act. The analysis should include reviewing the basket clause calculation related to the CAPROC investment. We recommend the calculation be performed on a regular basis throughout the year as well as at year-end to ensure conformity with allowable investment vehicles.

Document Storage

As mentioned in the past, the Retirement Systems are responsible for keeping many important documents and records that often times cannot be recreated (i.e., board minutes, member files, financial records, etc.). Given the very limited space allocated to the Retirement System's offices, it is difficult to provide adequate storage. It is imperative that the Systems maintain storage space that is not only well-organized, but also secure and fire proof. We recommend that the Retirement Systems review its current operating space and document storage facilities in an effort to improve conditions in order to ensure the safety of the related records.

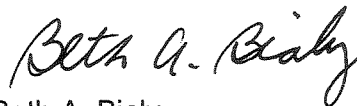
In the past we have suggested looking into document imaging. Document imaging would mitigate the need to retain paper files for extended periods. Documents would instead be scanned to create an electronic backup. Document imaging, while not necessarily a new technology, is being used increasingly as a means to provide a safe and effective back up solution while maximizing space limitations.

We also continue to suggest that the Systems should consider various aspects of disaster recovery. If there were a fire or other catastrophe and the paper records and/or computer system were destroyed, the Systems should have a disaster recovery plan in place. Plante & Moran's Technology Consulting Solutions Team would be happy to speak with you about opportunities related to document imaging and disaster recovery.

We would like to thank the Retirement System's staff for the excellent cooperation extended to us during the audit. We look forward to discussing our comments and recommendations with you. If you have any questions or require assistance in the implementation of our recommendations, please call at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



Beth A. Bialy



Wendy Trumbull